THE VIRGINIA STATE BANKER

Regulatory News for Virginia State-chartered Banks
State Corporation Commission - Bureau of Financial Institutions
Commissioner E.J. Face, Jr.
ISSUE NO. 11 ——— FALL 2000

IN THIS ISSUE

The Virginia State Banker is published quarterly by the Virginia Bureau of Financial Institutions to provide useful information to the banks and savings institutions that it regulates, and any of their related interests. Reader comments and suggestions are welcome and should be addressed to:

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Thanks to the following persons for their help in producing this issue of The Virginia State Banker:
Commissioner Face, Nick Kyrus, John Crockett, and Jane Owen.

SCC BEING STUDIED INSIDE AND OUT

Two separate but related studies of the State Corporation Commission and how it works are in full swing. The first, initiated by the SCC, is a comprehensive, internal assessment of the agency by an independent consultant hired by the Commission. The second, initiated by the General Assembly, is a broad assessment of the SCC's regulatory responsibilities, activities, and policies, and their impact on Virginia and her citizens.

SCC Chairman "Hulli" Moore told the legislative study committee at its opening meeting this summer, "The industries we regulate have changed and continue to change at a rapid pace. We believe it is proper that the General Assembly and the Commission perform a thorough review of what we do."

The Commission has employed David Wirick of the National Regulatory Research Institute at Ohio State University to evaluate the SCC. Wirick has already interviewed all SCC division heads and has held group meetings with other SCC employees. He is also speaking with representatives of the regulated industries to get their impressions of the SCC and how it does its work.

Wirick says, "I am extremely impressed with what I have seen so far. This Commission has a national reputation for being professional and responsible, and I haven't been disappointed." That doesn't mean there isn't room for improvement. Wirick says agencies like the SCC must change because "...the dynamics of the market in which the regulated industries operate has changed dramatically."

Wirick has helped a number of state utility commissions through this process already. The SCC is somewhat more challenging because of its added duties involving insurance, banking, securities, and the registration of all corporate entities that do business in Virginia. Wirick quickly discovered a common thread; they all now depend more on competitive market forces, yet continue to require government intervention to ensure consumer protections.

The breadth of the SCC's regulatory responsibility is the primary focus of the General Assembly study. Members of both the House and Senate make up the bulk of the study committee. But it also includes representatives of the Attorney General, the Secretary of Commerce and Trade, and four members

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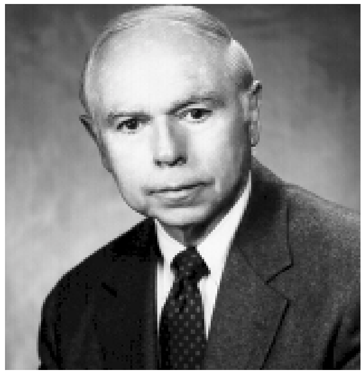
COMMISSIONER FACE URGES SENATORS TO FILL FDIC BOARD VACANCY

It's been one year since First National Bank of Keystone, West Virginia failed, costing the FDIC insurance fund $800 million. And it's been about as long since Arizona Superintendent of Banks Richard C. Houseworth was nominated by the White House to fill the vacant seat on the FDIC Board. Commissioner E. J. Face, Jr. is upset over the continued vacancy, and believes that the Keystone failure provides a lesson on why a full FDIC board with a state bank regulator is crucial to ensure the safety and soundness of the banking system.



RICHARD C. HOUSEWORTH

Commissioner Face has written Virginia's two U.S. Senators urging them to press their colleagues to approve the nomination of Houseworth, who is The Conference of State Bank Supervisor's (CSBS) immediate past chairman. Commissioner Face also supports House Banking Chairman Jim Leach's bill, H.R. 3374, that would return to the FDIC Chairman the authority to approve FDIC examinations of national banks. Commissioner Face is far from alone on Houseworth. CSBS has been lobbying in the Senate all year to win Houseworth's confirmation. The Senate Banking Committee held a May confirmation hearing, but the Houseworth nomination is stalled along with other nominations due to issues unrelated to Houseworth.

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NEW STATE FINANCIAL INSTITUTIONS

On November 2, 2000, the State Corporation Commission approved Fredericksburg Savings Bank, located in Fredericksburg, Virginia, to convert to a state bank under the name of Fredericksburg State Bank. The institution has total assets of $537 million and is a subsidiary of Virginia Capital Bankshares, Inc. The bank's Chief Executive Officer is **Samuel C. Harding, Jr.**

Hanover Bank, located in Mechanicsville, Virginia , opened on May 22, 2000. The bank's Chief Executive Officer is **William E. Martin, Jr.**

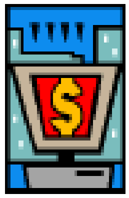
CLINTON NOMINATES REICH TO FDIC BOARD

The White House recently nominated John M. Reich, chief of staff to Sen. Connie Mack (R-FL), as a member of the FDIC board. Reich (pronounced "rich") is very well regarded as a long-term staff member on Capitol Hill. His confirmation is expected to be expedited in the Senate. Reich, a former banker, would fill the seat now held by Vice Chairman Andrew Hove, whose term recently expired.

Reich also oversees management of the Joint Economic Committee and Senate Republican Conference, of which Sen. Mack is the chair. Reich previously served as President and CEO of the National Bank of Sarasota and the First Commercial Bank in Fort Myers, Florida.

This is the second pending nomination to the FDIC board. Arizona Superintendent of Banks Richard Houseworth's nomination (see article above) to fill the vacancy in an unexpired term that ends in December 2001 has been before the Senate for over a year.

HIGH-TECH AND FINANCIAL SERVICES SURGE



The recent announcement of Capital One Financial Corporation ("Capital One") of its plans to expand operations in the Richmond and Northern Virginia areas by hiring 8,000 new employees is an indication of the continued momentum of high-tech expansion in Virginia. In the 1990s, high-tech employment in Virginia increased from 180,248 to 278,537, or by 54.5 percent. In both percentage and absolute terms, the increase was the highest in the Southeastern United States. Should this momentum in high-tech expansion continue, Virginia will become the "Silicon Valley" of the east. Capital One plans to construct a 1.5-million-square-foot office complex in the West Creek development of Goochland County, near the western Henrico County border. This facility will employ up to 6,000 people and should open by early 2002.

Capital One is a financial services holding company that owns Capital One Bank, a Virginia-chartered bank engaged primarily in credit card lending and the sale of various products using the latest technology. Capital One was spun off from Signet Bank in 1994 and is now one of the largest credit card companies in the world, with total assets of $15.1 billion at June 30, 2000. Capital One Bank recently received approval to establish a credit card bank in the United Kingdom and to establish a branch in Canada. Capital One Bank is the largest bank based in Virginia. Its primary regulator is the Virginia Bureau of Financial Institutions, State Corporation Commission.

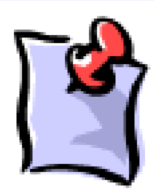
TALKS HELD ON "UMBRELLA" SUPERVISION

Functional regulation and coordinated supervision. Umbrella supervisor and primary regulator. We've heard these terms a lot since the Gramm-Leach-Bliley Act (GLB) became law in November 1999. What will they mean in practice? How will financial supervision change to meet the challenges of new business entities that bring together banking, insurance, securities, and other activities? What new roles and relationships will emerge among regulatory agencies?

State and federal officials tackled these issues in a multilateral way several weeks ago in a meeting convened in Washington. The Federal Reserve, the "umbrella" supervisor of diversified financial holding companies under GLB, called together the parties that will carry out coordinated state and federal supervision: representatives of CSBS, NAIC, and NASAA from state banking, insurance and securities departments; and officials from the Federal Reserve, FDIC, OCC, OTS, SEC and CFTC.

Representing CSBS were **Virginia Commissioner E. J. Face, Jr.,** Texas Commissioner Randall S. James, and New York First Deputy Superintendent Daniel A. Muccia. They joined in wide-ranging talks that laid out the perspectives of the various agencies. These talks will help build the communication and information-sharing infrastructure essential under coordinated supervision.

OTHER ITEMS OF INTEREST



Alliance Bank Corporation, located in Fairfax, Virginia, named veteran banking executive Thomas A. Young, Jr. as interim President. Mr. Young had been Senior Vice President in the bank's lending division since inception. His promotion comes after the resignation of David M. Cordingley, who is leaving the bank to pursue new business interests and opportunities.

BUREAU EXAMINERS TACKLE FRAUDS, FAILURES, AND RISKS

Even as the Bank of Falkner case (fictitious bank) was coming to resolution, more than 40 examiners from six states (over 20 from the Virginia BFI) gathered in Richmond, Virginia October 2-5, 2000 for The Conference of State Bank Supervisors' School of Hard Knocks. For three and a half days, they studied fraud prevention approaches, lessons learned from bank failures, current economic conditions, credit and risk issues, blanket bond coverage, and other challenges for banks and for state banking supervision.

Jeff Jungman, Assistant to the Superintendent for the Iowa Division of Banking, presented "Lessons Learned from Bank Closings." Of the 1,617 banks and savings and loans that closed between 1980 and 1994, 25% were due at least in part to fraud and insider abuse, according to the FDIC. Poor management and a lack of internal controls allowed the fraudulent activity to flourish.

Jungman noted, for example, that off-site examinations must be understood as tools in a comprehensive supervisory process. Of those same 1,600-plus failures over 15 years, 36% had CAMEL ratings of 1 or 2 for two years before failure, while only 39% had 4 or 5 ratings. "The CAMEL rating is a snapshot in time, not a forecast," he explained. Jungman said that one of the key lessons is that problems must be identified at an early stage through continuous monitoring and up-to-date on-site examination techniques. Examiners must be aware of emerging risks, he said, and look behind the fact that an activity may be legal and profitable. It may also impose new and significant risks on the bank.

The examiners pointed to several issues of particular concern that were raised during the presentations. One is their feeling that accounting rules seem to be at odds with bank safety and soundness principles, particularly in two areas: (1) the way in which banks are required to book residuals from asset securitizations, and (2) the Securities and Exchange Commission's effort to impose new rules on how banks manage their loan loss reserves.

The examiners also said they were surprised to learn about weaknesses in blanket bond coverage for banks. In his presentation, attorney Pat Ardis of Wolf Ardis told the examiners that they should undertake a careful review of each bank's bond coverage, and that they should discuss the coverage with the bank so it can improve its policy. The examiners also widely agreed on the essential job of validating and verifying all information, and that it is important whenever necessary to ask for more documentation and to thoroughly analyze the documentation.

BUREAU MEETINGS WITH BANK CHIEF EXECUTIVE OFFICERS WILL CONTINUE

Over the past year, Commissioner Face and senior Bureau staff held "regional" meetings with bank CEOs to discuss issues of mutual interest including, but not limited to, the Bureau's goals and objectives, examinations, economic developments, financial modernization, privacy, Internet banking, etc.

The intial feedback has been very positive and the dialog between the Bureau and the bankers has been extremly informative for all sides. Based on the response from participants, it has been determined that these regional meetings will once again be conducted in the coming year. Look in the next issue of the Virginia State Banker for the time, date, and place for the next "Commissioner's Forum" meeting to be held in your region of the state.

BUREAU PROFILE

- **Name**: Marvin M. Brooks
- **Current Position and Years of Service**:
  Principal Financial Analyst; 13 years
- **Main Responsibilities**:
  Supervising Bank Examinations
- **Education and Professional Designations**:
  Norfolk State University
  Bachelor of Science - Accounting
- **Family**: Wife - Valerie and Son - Marvin, 13 years old
- **Personal Interests**: Enjoys watching son compete in sports; riding motorcycle; attending auto auctions; reading and watching sports on television.

After spending most of the week on the road examining banks, Bureau Examiner Marvin Brooks says he thoroughly enjoys "kicking back" at home and being with his family. Marvin takes a keen interest in the athletic endeavors of his son, Marvin, Jr. His son competes in several sports, including football, basketball, and baseball. Marvin states that when he's not following his son's games, he is a self-professed "couch potato" watching sports on television at home. When he does get active on the weekends, Marvin loves to ride his motorcycle during the warm months, and he has even been know to ride it when leaves home to examine banks! His interest in "wheels" also extends to attending auto auctions when he has the time.

Marvin was an avid sportsman while growing up in Gloucester, Virginia. As a youth, Marvin said he spent much of his time hunting and fishing in the rural countryside of Virginia. After graduating from Norfolk State University with an accounting degree in 1982, Marvin committed to four years of active duty in the U.S. Army. While in the Army, he was stationed in Korea and Ft. Knox, Kentucky. Marvin is still a Major in the Army's IRR (Individual Ready Reserves), and he says he can be called up for active duty on short notice.

Marvin said one of the funniest things that has happened while he was conducting a bank examination was when he was examining a bank in Gloucester. He said a former highschool classmate that worked at the bank shared their old year book with the other examiners! When asked what he enjoys most about his work the past 13 years as a bank examiner, Marvin states " I have really enjoyed meeting people and traveling to different parts of the state." Well, it looks as though Marvin will continue to enjoy that aspect of his job for many years to come, just as long as he is able to get home on the weekend in time for the kickoff, tipoff, or first pitch of his son's game!!

SCC STUDY (Continued from page 1)

appointed by the Governor, from the state's largest electric company, telephone company, and railroad company.

The study committee chairman is Senator Thomas Norment, the patron of the legislation that allowed competition in the electric industry. Senator Norment also sponsored the resolution authorizing the study of the Commission. He considers the study, "...a significant initiative of the General Assembly."

Senator Richard Saslaw stated, "....this study ought to be about the proper role of the SCC in this changing environment." He added, "We need to use this opportunity to set a new course for the SCC." Senator Ken Stolle offered the fundamental question, "Is the Commonwealth of Virginia best served by the SCC as it is now [with] its current makeup?"

The SCC's internal study is on a fast-moving timetable. An interim report to the Commissioners is expected by January 2001. The Commission intends to advise the legislative study committee of Wirick's recommendations. The legislative study will continue until January 2002.

FDIC BOARD VACANCY (Continued from page 2)

Although the Virginia Bureau had no involvement in Keystone, Commissioner Face is concerned that the FDIC Board vacancy exacerbates a situation that may have contributed to the Keystone failure. Commissioner Face cites Chairman Leach's comments at the February 2000 hearing on the Keystone failure at which Leach reminded everyone that the OCC and the FDIC had once operated under a "collegial arrangement." Before 1993, the two agencies had a coordinated examination agreement on national banks.

"The Keystone case also brought to light a potential problem in the coordination of federal bank regulators with respect to FDIC special examination authority," Leach said at the hearing. "This collegial arrangement changed in September 1993," he explained, "when the FDIC Board, with two vacancies and therefore dominated by the two Treasury Department representatives, the OCC and the OTS, voted to end this arrangement." Since 1993 if the OCC or the OTS objects, the FDIC must get FDIC board approval to enter and examine a nationally chartered bank or a federally chartered thrift. That's why a full FDIC board of five directors is so important.

The FDIC Board acted in 1993, Leach explained at the hearing, "...despite the explicit written communication to the FDIC by then-House Banking Committee Chairman Henry B. Gonzalez and me, the then-Ranking Minority Member, that Congress had serious reservations that the proposal would have the effect of the FDIC improperly derogating its authority."

The Gonzalez-Leach letter of 1993 stated that "...the FDIC must be able to independently examine all depository institutions." Leach said he introduced H.R. 3374 to give the FDIC Chairman rather than the FDIC Board the authority to send FDIC examiners into any insured institution. "This provision," he concluded, "would underscore statutorily the long-standing intent of Congress that FDIC back-up authority must be of an independent nature."

Some argue that in the Keystone case the FDIC had little opportunity to prevent these losses because the OCC objected to the FDIC sending its examiners in to Keystone until it was much too late. The OCC disagrees, stating that an FDIC examination would not have changed the outcome on Keystone. The larger issue, though, is that a full FDIC Board with a state bank regulatory voice ensures coordinated supervision from all relevant agencies and is vital since the passage of Gramm-Leach-Bliley.